

The Company Prenup: Three Reasons Why an Operating Agreement Is Essential for Your Business

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Starting a new professional practice or other business with a colleague, friend, or family member is like a new marriage: it usually starts off happy. As a result, it is easy to rely upon a “handshake deal” or a verbal agreement instead of entering into a formal operating agreement. But this informal approach has several pitfalls that frequently lead to expensive legal problems down the road, when things are not so happy anymore. Here are three common ones:

1. Breaking Up Is Hard To Do. Many state statutes have strict requirements for expelling a member of a limited liability company or dissolving a business. So if your business partner(s) will not agree to the breakup, achieving a court-ordered breakup is no guarantee.

In an operating agreement, you can clearly define if, how, and when one of the business owners can be removed from the company, as well as the amount and terms of the buyout.

2. It Is (Always) About The Money. While contributing a valuable product or service to the local community may be an important part of your new business’s mission, you are no doubt focused on the bottom line. Often, owners will verbally agree to work equally and earn the same amount of compensation. But what happens if some of the owners are not pulling their weight? This is a thorny issue and frequently leads to messy legal battles in court.

In an operating agreement, you can specify each owner’s work hours and responsibilities, and include provisions about how salaries and bonuses will be calculated.

3. Whose Stuff Is It? When starting a new business, each owner may have her own clients that she is “bringing to the table.” Similarly, some owners may contribute a unique product or service that the company can market and sell. If things go sour, who gets to keep these clients? Who gets to keep these products and services? Divorcing business owners often find themselves in costly litigation over “who gets to keep what” after the relationship is over.

In an operating agreement, you can include terms protecting the clients and proprietary materials you bring to the company.

It is natural to think at the beginning of any new relationship that nothing will ever go wrong. And sometimes things work out that way. Hope springs eternal. But, in business, it is far more prudent to set the rules of the game in advance. A formal operating agreement – your company prenup – will ease the transition if you decide to go your separate ways later.

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