The Big Break-Up

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Pamela Mills-Senn

The dissolution of a partnership doesn't have to be painful

If a restaurant partnership is similar to a marriage (as many will attest it is), then dissolving a partnership must be very much like going through a divorce — which should be a scary thought for anyone contemplating such a move.

"Unfortunately, partnership split-ups are like family divorces," says J. Philip Kirchner, an attorney with Flaster Greenberg PC. The law firm's main office is in Cherry Hill, New Jersey. "They are, in most cases, acrimonious and nasty, with both partners making decisions based on negative emotions rather than good business judgment."

Taking the low road can prove ruinous for the restaurant and the lives of those involved, says Aaron Allen, founder/CEO of Aaron Allen & Associates, an Orlando-based global restaurant and hospitality consulting company. He recalls one situation that resulted in a protracted, years-long lawsuit that included death threats, physical assault and the need for security. Having something in place, like a buy-out agreement, may have prevented this outcome or at least shortened its duration, says Allen.

Partnership agreements covering all aspects of the relationship — including dissolution — are essential and should be established from the start, says Kirchner, adding that the true danger lies in having no agreement in place, or a very weak one.

"In such cases, unless the parties can reach a private amicable resolution — very difficult to do in most partnership 'divorces', the parties will almost certainly end up in court in a lawsuit," he says.

But even with a solid agreement in place, partners might do well to pause and consider if such a dissolution is really necessary, says Dennis Lombardi, executive vice president of foodservice strategies for WD Partners, a Columbus, Ohio-based design and development company for chain retail/hospitality.

There are often good reasons to dissolve a partnership, such as illness, retirement, loss of a lease or unsustainable unit economics, he says. Irreconcilable operational differences in philosophy or style that are negatively impacting the business can also make splitting up the best option. Other good reasons include when there's been a change of passion or focus, when one partner wants to grow and the other doesn't or if one of the partners has pending legal or financial liabilities that could threaten the business, says Allen. However, both consultants agree, too often partners are motivated by the wrong (and potentially fixable) reasons, such as personality conflicts, pride and ego.

"Ego is the worst, and it's a more common driver than people want to admit," says Lombardi. "One partner starts thinking he can do it better, or that he's doing all the work and doesn't need the other partner. But the reason they came together in the first place is that they had some synergies."

Before boarding the train to splitsville, the partners should examine if their differences are actually undermining the operation, says Lombardi. If not, then perhaps attempting to work things out might be the best option. Other questions he suggests exploring include:

Can the restaurant, and its employees, survive the process?

- Will the parties be better off than before?
- Will the costs turn a plausible/good decision to separate into a bad one? "For example, you may have to hire a GM to replace the partner" Lombardi says. "Or the partner who leaves may have important connections."
- Will key people leave?
- What are the strengths of the surviving partner? What are his/her weaknesses and how will he/she compensate for these?

If the decision is to divide, expect surprises, says Allen. "The other partner may have been doing more than you thought — we find this a lot," he says. "Also a surprise sometimes is who the vendors, employees and other (nonfinancial) partners side with."

Other unanticipated issues can include hidden liabilities, such as the threat of a lawsuit the remaining partner didn't know about, cooked books, over- or under-valuation of the business — even things like company passwords, contact lists or accounts, Allen adds.

Seeking professional help (in addition to an attorney) during the process is generally required. "Start with a professional valuation of the business," says Allen. "Have audited financial statements and have this facilitated by a third party."

Consultants can help keep "hotheads" away, keep the situation from escalating, and also assist in separating duties, he continues. "You'll also need an accountant and in some cases a transition team, or someone who can come in and play a leadership role." (If there are serious differences/disagreements, consider calling in an executive coach or conflict resolution coach, says Lombardi.)

Allen suggests explaining what's happening to vendors and employees. They can sense something is amiss, he says, which can quickly unravel morale and the restaurant's health.
This is the time to calmly think about the other person's needs, not just yours, says Lombardi.

"Try becoming the other partner's advocate," he suggests. "What are her concerns? How do I protect him? If people come at it for their own gain, the legal fees will be prohibitive.

"Keep the process as fair and practical as possible. If you can try to get consensus without browbeating, if each person isn't completely happy, then it's likelier to be a fair deal."

The Partnership Agreement

A solid, comprehensive Partnership Agreement (or LLC Operating Agreement or Shareholders Agreement) can make a break-up less painful, says attorney J. Philip Kirchner. Although he says there are numerous other provisions an agreement can include, the following provides an abbreviated listing of the most typical ones specifying:

- Who will own the business (in what shares) and who will manage it?
- How voting deadlocks will be handled.
- What happens if/when the partnership needs additional capital?
- How profits will be calculated and distributed to the partners (Guaranteed salary? Draws against profits? Etc.).
- How financial records will be kept, and who will keep these.
- What other reports will be run and who's in charge of these. Also, who will receive them?
- A "tax matters partner" charged with overseeing filing company tax returns, etc.
- The procedure for admitting a new partner and the voluntary/involuntary withdrawal of a partner.
- The mechanism for resolving disputes.

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ATTORNEYS MENTIONED

J. Philip Kirchner