12 WARNING SIGNS YOU'RE HEADED FOR A LAWSUIT WITH YOUR PARTNER

LERMAN LAW PARTNERS, LLP

THE REAL ESTATE INVESTOR'S LAWYERS℠

SPECIAL REPORT

12 WARNING SIGNS YOU'RE HEADED FOR A LAWSUIT WITH YOUR PARTNER

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INTRODUCTION

Joint ventures or partnerships[1]—the coming together of two or more parties for a common purpose—can be one of the most powerful ways to do business. When done correctly, joint ventures can help all involved achieve more than they could do by themselves, do business more safely by diversifying their risk, grow their business, save time, connect with like-minded individuals, have more fun, hold each other accountable (in a positive sense), and ultimately make more profits for all. However, whenever two or more people do business together and money is involved, there is the potential for disagreement, disputes and disaster.

This Special Report will outline 12 warning signs (derived from the author's decades of experience handling real estate partnership formations and disputes and discussions with other real estate lawyers and investors) that you may be headed for a lawsuit with your joint venture partner. If you encounter one of these, it does not mean you will definitely end up in litigation with your partner. It is a "warning" that you should heed and try to take immediate action to deal with it. If you are already in a lawsuit with your partner, consider the following as a checklist to use when forming your next joint venture to minimize the chance you will end up in a dispute with that partner.

[1] The terms "joint venture", "partnership" and "partner" are used in their broadest, non-legal sense. When two or more people come together to do business, that is loosely referred to as a joint venture or partnership. However, they may ultimately choose a legal entity in which to do business that is neither a joint venture or a partnership (for example, they could form a limited liability company or a tenancy-in-common). That more technical legal discussion is outside the scope of this article.

#1: Communication Breakdown

A joint venture or partnership is a business marriage. And, just as in marriage, good communication is probably the single most important requirement to maintain a healthy business relationship. If your partner “goes dark” on you, if they stop answering your phone calls or e-mails, or if you start noticing a different tone in their voice, those can all be signs that your joint venture is in trouble. I had a client once who called me one day and was extremely concerned and furious because he arrived at his office that morning only to discover that the locks had been changed and he couldn’t get into his own office! When I asked him if he knew what happened, he replied that when he called his business partner to find out if he knew what was going on, his partner told him “I’ve been trying to talk to you for weeks about our problems and you keep ignoring me. This is what I had to do to get your attention!” Don’t let your relationship degrade to such a severe breaking point. If your communication with your business partner starts to deteriorate, that is the #1 sign your relationship is in trouble. Take the initiative ASAP and start a candid, non-confrontational conversation with your partner to ask how they are doing and whether there is anything going on with your partnership that has been troubling them. Then, LISTEN!

#2: Lack of Money

It is not unusual to have one partner who has less financial resources than the other. However, when partners come together with the expectation and/or agreement that they will each contribute certain money up front and more later, if the situation warrants it, it is not uncommon for the financially-weaker partner to come up short. In fact, that is one

of the most common disputes between partners. So, if you are in a joint venture with one or more partners who are tapped out, that is a huge warning sign that you are headed for a serious discussion when the joint venture needs more money to stay in business. What can you do? Bring up the topic as soon as possible in a calm, business-like manner. Discuss options to deal with "our problem", including a possible re-adjustment of profit/loss interests. Document your agreement.

#3: No Written Agreement

A shocking number of joint ventures are done with no more than a handshake. It is virtually impossible for two or more people to embark on a joint venture with any level of confidence that they: (a) covered all the points that need to be addressed during the lifecycle of that venture; (b) covered those points in the necessary level of detail, and; (c) will recall what they agreed exactly the same way when they need to remind each other of that agreement when it matters most—when there's a disagreement. Even if they could do ALL of those things, good luck proving your oral agreement in a court of law. If you have no written agreement, that is another major warning sign that you are walking through a minefield blindfolded, headed for disaster. Solution: hire a competent lawyer and get your agreement in writing…*yesterday*!

#4: *Written agreement without clear definition of who's contributing what*

OK, so you're feeling good that you already have a written agreement with your partner. The problem is that if the agreement did not adequately address key points, such as who is contributing what to the joint venture in terms of time, money, property or effort, then

that void creates a fertile ground for future disagreement. What are the odds that your agreement is missing such key items? Unfortunately, it happens all the time. Solution: amend your agreement with a competent lawyer (consider using a different one than the one who drafted up your defective agreement in the first place) ASAP!

#5: *Written agreement that does not address cash calls*

All too often, written agreements fail to address this sensitive issue: What happens if, despite your best-laid plans and projections, your venture ends up needing more money than you planned and originally contributed to capitalize your deal? Perhaps the venturers do not want to consider this possibility up front. Regardless, it should be discussed and the agreement documented. If your agreement does not address this, then when storm clouds start to form over your venture, you are headed for a tough discussion with your partner that could result in a lawsuit. It may not be too late. Sit down with your partner right now and have the discussion you should have had when you first got together…and document it!

#6: No tie-breaker mechanism

If your venture is made up of just two partners and you each have a 50% vote on any issue, there is the potential of deadlock. What happens if you just cannot agree? On a minor issue, you might be able to avoid a serious dispute. The bigger the issue, the more likely it is that you will end up in a lawsuit. Solution: Try to agree that one of you ultimately has control on all decisions. Often, that is the person who has the most hard dollars in the deal. If that is not possible, consider agreeing upon a neutral third party

upfront to be the tie-breaker vote and make that vote binding. If that is not possible, include a mandatory mediation clause in your agreement.

#7: Previous bad track record of partner

If your partner has a bad track record (failed businesses, failed partnerships), that is a warning sign that they will continue in the same path. Sure, people can change. But if you are playing the odds, the odds are that a past bad track record will repeat itself in some way, shape or form in your experience with that partner. Ask your prospective partner about their business history. If you are already "in bed" with your partner and you do not know this information, it is not too late. Ask. If you do not like what you hear, do your best to mitigate whatever risk you learn about based on their prior history on a going-forward basis.

#8: ***Partner has no track record***

If this venture will be the first time your partner is trying this business, odds are they will make mistakes while learning the business "on your nickel". Their mistakes can translate into disagreements and disputes with you. Be careful. Generally, it may be better for you to let them create a positive track record before joining forces with them.

#9: ***Not using lawyer or using inexperienced lawyer to handle documentation of deal***

All too often, we see in our office agreements drafted by non-lawyer clients who were trying to save a buck (on transactions involving millions of dollars no less!) or by lawyers who were outside their core area of expertise. That can, and frequently does, result in

disputes arising from a defective document. Solution: Always, always, always hire a competent lawyer to draft these important documents. The investment will pay for itself many times over in the savings you will hopefully realize in not having to pay a litigator later to prosecute or defend against a lawsuit.

#10: *Partner has past track record of being litigious*

You should do "due diligence" on your prospective partner just like you do due diligence on your investments. One of the things you should investigate is how many times they have been a party to lawsuits. The results can sometimes be shocking. In doing a 5-minute free online search of a county court database, we discovered that an individual who we were contemplating forming a new joint venture with had been involved in *69 lawsuits*! And that was just in one county. Anybody who finds themselves in court that frequently should not be high on your list of potential partner candidates. See #6 above.

#11: Sloppy books and records

If your partnership keeps sloppy books and records (non-contemporaneous entries, lack of entries altogether, commingling of funds, etc.), there is an excellent chance that when it comes time to settle up and pay out profits (or require more money in the form of cash calls), there will be a vigorous dispute over who is entitled to what. Solution: Do whatever it takes to nip this problem in the bud now. Clean up your books and records immediately.

#12: No glue

"Glue" is what holds two or more people together. If one partner believes (rightly or wrongly) that they do not need the other partner, the partnership is on thin ice. Of course, if there originally was glue that brought you together, then that must be respected and should hold you throughout the intended term. If, however, one partner is just skating by without demonstrating their value to the other, it is probably only a matter of time before the "independent" partner to start resenting sharing the pie with the "freeloading" partner. It is never too late to add glue to the relationship. Evaluate what you have to offer. Be a good partner. Blow your partner away with the value you bring to the table.

CONCLUSION

The above list is not intended to be comprehensive, but just some of the more common warning signs I have witnessed over the 35 years I have been a lawyer. The odds of making it in business are hard enough. There is no need to increase those odds by taking the *completely unnecessary* risk of joining forces with a partner without paying attention to the above simple warning signs. If it is too late and you are already in a dispute, our office also handles litigation and creative dispute resolution.