Surviving a Deadly Partnership

It's not likely your business partner will attempt to kill you like Phil Rouse's did, but you can still learn a lot from his story.

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Entering into a business partnership is always a shaky proposition. Will you agree on the business's mission? Will you take equal parts in the actual operation of the business? What if your partner shirks his duty? Or mishandles money? Or...tries to kill you?

The last "or" probably sounds too far-fetched to be on your list of worst-case scenarios. And maybe it is awfully unlikely, but Phil Rouse never thought it would happen to him, either.

Ever since Rouse, 63, bought a 1930 Model A Ford when he was just 20 years old, he had one dream: to open a shop restoring antique cars. In 1997, he made it happen: He left his job and opened a shop. One day, his neighbor of 15 years stuck his head over their shared backyard fence and asked whether he could join in as a silent partner. He'd put up $5,000 and take care of the paperwork. "I thought, what a sweet deal," says Rouse. "If I don't have to worry about paperwork, that's gonna be great. Because, really, my fun was restoring the cars."

The business immediately did well, with two cars in the shop and 30 on a waiting list. But Rouse soon became mysteriously ill. He stopped working; his two employees kept the shop running in his absence. Twenty thousand dollars in medical bills later, doctors couldn't determine the cause. "I was just suffering like a dog," says Rouse, who lives in Memphis, Tennessee. "One doctor even suggested I go see a psychiatrist."

What happened next seemed too surreal to be true. Rouse discovered his partner was stealing money from the business after one of their employees told him two suppliers had put them on a cash basis because they weren't getting paid. He asked his neighbor about it, and he shirked the question. Rouse found canceled checks to an insurance company--and he recalled his neighbor once proudly admitting his knowledge of poisons. The clues came together. "It seemed like every time we ate together, I'd get sick," says Rouse. "It occurred to me that because he knew I was becoming suspicious about the theft, was it possible this guy was trying to kill me? It sounded as far-fetched to me as it did anyone else."

Rouse told his doctor the story and received a heavy-metals test. While awaiting the results, he was in so much pain, he even went to police with his story, asking for an autopsy in the event of his death. The test came back positive: He'd been poisoned with arsenic and mercury.

An investigation ensued, and slowly, all the partner's misdeeds surfaced. He had obtained a $100,000 keyman life insurance policy on Rouse and transferred all of Rouse's business assets into his name. Money was missing from the business. Revenues were underreported regarding sales taxes.

The neighbor is now serving 35 years--six of which are for theft-related charges--and Rouse is in a wheelchair, dealing with the physical and financial repercussions of these crimes and moving on with his life. "I don't want to sound like a hero, but there's nothing I can do but accept what's happened to me," says Phil. "And of course, I'm confined to a wheelchair, but I have to remember that I walked for 60 years. And there are a lot of people who never walked at all."

While Rouse laughs when asked about ever going into a business with a partner again, many would-be and current entrepreneurs like you are doing just that. And while it's highly unlikely your partnership will end as horribly as Rouse's did, you still need to enter into your partnership with eyes wide open.

Rouse never got his own attorney; he let his neighbor take care of that. He never did a financial background either; if he had, he would have discovered his partner was $90,000 in debt. What are some other things you want to make sure you do before you enter into a partnership? We've asked three of our experts for their advice.

Expert Advice

Keith Lowe, Start-Up Basics

Lowe is an experienced entrepreneur who is a founder and investor in companies in several industries. His current projects include B2Secure, Digital Graphiti and Stellar Homes. Lowe also mentors new entrepreneurs and is a co-founder and officer for the Alabama Information Technology Association.
What would you suggest new business owners do before entering into partnerships?
Keith Lowe: As much as possible, know who you are dealing with, [and] don't go into business with people you don't know. Get with an attorney and have them draft a partnership agreement (or corporate documents) that explain exactly how, if it becomes necessary, the partners can split up. It is almost impossible to run a company by committee, so agree upfront who will be in charge.

What would be some warning signs that it'd be best to go into business alone?
Lowe: I think this is more a question of what kind of person you are. Some people are loners who should do it alone, and some people like (and need) to be in a group setting and have peers in the business.

What type of background information should you seek on your potential partner?
Lowe: As much as possible. When a VC invests in your business, they will do a criminal background check on you, hire a private investigator, do credit checks, etc. There is a reason for this. If you really want to become partners with someone you don't know (and can't vouch for), then find out as much as you can, and structure the business such that if you don't get along, you can split up without having to lose all you've worked for. Usually, one person will buy the other out.

The opinions expressed in this column are intended to be general in nature, without regard to specific geographical areas or circumstances, and should only be relied upon after consulting an appropriate expert, such as an attorney or accountant

Stever Robbins, Business Leadership Expert

An executive coach, facilitator and professional speaker on leadership, ethics and technology, Robbins works with business leaders to help them develop the skills, attitudes and capabilities they need to succeed. He's been involved with start-ups since 1978 and is an investor or advisor to several technology companies. You can find him online at http://LeadershipDecisionworks.com.
What should you look for in a partner?
Stever Robbins: Someone you can trust, who complements you. You want enough self-knowledge to know where your skills are strongest, and find a partner with a different skill set. If you're the marketer, be on the lookout for operations and finance skills. You also want a good match around values, as a strong values connection is what will hold you together through times when you may disagree on specific implementation issues.

What types of questions should you ask of potential partners?
Robbins: Ask open-ended questions about past business situations that have been troubled, that have worked well, that have ended badly, and that have ended well. Dig into what's gone wrong/right that has produced those outcomes. Listen for any patterns in your prospective partner's responses that would indicate a values clash or someone who would be tough to work with.

Also listen for the skill sets they seem to enjoy using and are good at. Make sure those skills complement yours. Ask about and carefully consider how they resolve conflicts of responsibility, authority and strategy.

What are some warning signs of a potentially bad partnership?
Robbins:

- You don't like the style of your interaction when you're negotiating the partnership.
- Partner's reluctance to explore terms of the relationship beforehand--e.g., terms of separation, inheritance rights for stock, etc.
- Partner reluctant to have unequal responsibility/status. ("You get to be CEO--so should I!")

- Partner has a limited track record working successfully as part of a team.
- Partner won't discuss money and its implications openly.

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Judith Silver, Legal Expert

Judith Silver is the CEO and founder of Silver Law Inc., her technology law practice, and Coollawyer Inc., an online legal forms company. Both are virtually located at www.coollawyer.com. Silver is licensed in California, Florida and Texas.

What's your advice to Rouse?

Judith Silver: Well, first thing is that I would have advised Rouse not to form a partnership. The type of partnership Rouse formed, without an agreement or registration with the state, was implied by state law based on their actions as a "general partnership," which means that all partners (there may be more than two) are liable for the debts and liabilities of the partnership jointly and severally--or they are each fully, and sometimes personally, liable for the acts of the other partners.

If the partnership were to have one party as a "silent" partner, which usually means that such party only contributes funding, then that partner would be a "limited partner." If Rouse had limited partners, he would have had to form a limited partnership, which is done with a partnership agreement and registered with the state of formation. Limited partners are only liable up to the amount they have contributed to the partnership, are not liable for other partners' actions, and do not participate in any aspect of running the partnership. State laws vary considerably with regard to general and limited partnerships, so if Rouse were to expand the business to other states, there might be burdensome requirements for him to comply with if he picked a partnership structure.

A much better choice when creating a business is a corporation, or if you prefer more flexibility and the (sometimes advised) tax benefits, a limited liability company (LLC). Both of these structures provide ways to ensure that the managers of the business are not personally liable for the acts of each other and the business. This means Rouse wouldn't have been personally liable for all the partnership debts his neighbor created.

Additionally, with a correctly structured corporation or LLC, Rouse could have required his and other managers' signatures when the business, or an authorized representative, accessed funds at the bank, signed contracts, transferred assets or purchased insurance on key employees.

Some of these matters are already part of the statutory structure of corporations as part of the roles of shareholders, boards of directors and officers; if you formed an LLC, they could be created in the Articles of Organization. While these structures aren't bullet-proof against criminal acts by management,

they do, with clarity, give both the business and the shareholders (in the case of corporations) rights to sue the officer or director to recover any funds that are illegally diverted. The difference between corporations and LLCs is that corporations rely on procedures already existing in state law, which are more or less uniform around the country. LLCs require recreation of the business's own ways to handle the notions of shares, officers, control, transfer of assets, etc. in the Articles of Organization, and state laws vary with regard to LLCs and their treatment.

What else could Rouse have done to protect the company's assets and money?
Silver: If you are running a business, you need to pay attention to the "paperwork"--both legal and tax. The actions of the business and its employees reflect on you. Even if there is no theft, you always want to know what's going on, what legal commitments have been made, what legal regulations the business is subject to, what the business's tax returns say, and other important "paperwork" items.

For reasons now obvious to Rouse, it's extremely important to regularly and often watch business funds and check your bank statements to monitor whoever is handling these accounts payable and receivable. Remember, if you delegate check-signing ability, that person can write himself a check for everything in the account and disappear, so you need to be very sure you trust that individual and have legal or other structures in place to try to prevent that outcome. Often a good way to handle this is to require two signatures on checks and commitments of the business so that the signers can keep an eye on each other.

Should Rouse have hired his own attorney?
Silver: It's very important that the business have one lawyer to represent it--as a separate legal entity than any of the shareholders, officers, employees or directors, and that any of these parties have his or her own lawyer. The business and persons working for it, or investing in it, have different goals and need different legal advice to be sure that their goals are achieved and each is protected in the relationship.

Also, even among the founders, each may have different financial contributions, different work contributions, different control levels in the business, different goals and levels of risk. Some attorneys will offer to serve on behalf of all parties in these situations, but that is not a wise choice. The process of each party understanding how their goals and risks differ, which becomes apparent during such negotiations and drafting of "paperwork," is a valuable one that often save massive amounts of grief when the business is breaking up or one party wants out.

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