

Partnership Agreements for Law Firms

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Executive summary

MOST PARTNERSHIPS have formal partnership agreements, normally in the form of a deed, although it is surprising how many firms manage to exist on informal arrangements. Many firms have an agreement, perhaps as a result of expansion or merger, which was at the time well thought out and suited to the firm as it then was, but which has subsequently been largely ignored because there seemed no need to revise it or because the task of revision was too daunting for the available management time.

Solicitors accept that they must constantly adapt to changes in the law and they have become used to regular and invasive changes to the regulations which govern the way they may operate. These changes create considerable burdens for busy practitioners and it is therefore perhaps unsurprising that those managing solicitors' firms may – even if they recognise that changes in what they are permitted to do in practice also affect how they are entitled to manage their own businesses – find insufficient time to do anything other than add another patch to the partnership agreement to deal with the latest problem that has arisen.

In the time that has passed since many partnerships were formed and their agreements settled, new rules of conduct have come into force that require firms to comply with management obligations, varying from the obligation to have catastrophe contingency planning to the promotion of equality and diversity within

the firm. A breach of these rules is a matter of conduct and can lead to disciplinary sanctions. Many partnerships were formed long before the Limited Liability Partnerships Act. Many partners will have looked at the basic provisions and perhaps even have attended lectures on the subject. Some will have determined that LLP status does not suit the culture of their firm, some will not wish to put up with all the upheaval that would follow change, and some will simply have been reluctant to change what they perceive to be a successful partnership arrangement.

While LLP status still may not suit many firms, and the purpose of this report is to deal with the issues that arise for those remaining in partnership rather than converting to LLPs, the fact is that firms change and their requirements change with them. It is therefore appropriate to consider, if only briefly, the difference between partnerships and other forms of practice which are permitted. These differences are not simply differences of disclosure and liability but can affect the cultural ethos of a firm and the way in which it can manage its junior solicitors. This is dealt with in Chapter 1.

The government has been at some pains to emphasise its wish to see the traditional concept of solicitors as a profession being converted to the business of providing legal services, and the Legal Services Act 2007 has been passed to that end. Apart from its other changes, such as the transfer of regulatory supervision to a new authority with other authorities having delegated powers,

the Act permits a limited form of outside investment in, and management of, legal firms probably after April 2009, although the timetable is subject to possible delay by the Ministry of Justice. Although the regulations relating to these new types of firm have not yet been published, Chapter 2 gives an overview as to how this regime will operate.

In the current climate many firms may be reluctant to expand but may wish to consolidate their capital base by seeking new partners and Chapter 3 looks at how the status of the firm may affect its attractiveness to new partners.

Before any full consideration of a partnership agreement can be properly dealt with, the management of the firm, and ideally all of the equity partners, should look at how it is actually run, whether that is how the partnership agreement envisaged it would be run, whether it is an appropriate manner of running a firm in current regulatory and market conditions, and how it should be run in the future, for example after the retirement of senior management. Chapter 4 addresses this issue.

A matter often overlooked by even the largest firms is the status of salaried partners. Particularly in dismissal, discrimination and dissolution cases, ambiguities in the status of salaried or junior partners can cause considerable and expensive problems. Chapter 5 addresses this issue.

Chapter 6 is concerned with discrimination, particularly age discrimination as this is a relatively new and difficult area for partnerships. This is particularly so because many, if not most, partnerships will have partnership agreements which are discriminatory, and it will therefore be necessary for them to justify the discrimination as being lawful.

The minefield of discrimination affects the manner in which profits can and should be

shared between partners. Lockstep and merit-based systems are examined in some detail in Chapter 7 and suggestions as to hybrid systems which partnerships may find suit their particular circumstances are also discussed.

It is of course the case that most partnerships will wish to tailor their remuneration policies to reward and maintain their existing partners while encouraging younger ones to put in the time and dedicated effort necessary to achieve senior status. Chapter 8 deals with new and junior partners and the types of partnership arrangements which may apply to them. The management of any business has to balance not just its financial survival and profitability but also the service it provides against the demands that are made on its managers and staff. Solicitors' firms are no different, except perhaps that they have a higher duty to their clients and the strains on those providing the service are therefore perhaps greater.

Provisions for staff to enable them to have some part of their life not wholly devoted to their particular field within the firm may also be of benefit in recruiting, retaining and motivating staff and partners, and this is discussed in Chapter 9. Whether or not the staff are motivated, it is an absolute essential for all management that effective discipline and control over partners as well as staff can be maintained, not only to prevent lapses of discipline and attention which might lead to reputational damage or a claim against the firm, but also to ensure that discrimination and bullying cannot go undetected and unpunished. With discrimination law as it is at present, this requires agreement within the partnership specifically designed to allow those managing it to ensure compliance and this is discussed in Chapter 10.

In the current economic climate, many firms have suffered a decline in business

volumes, some of which may affect entire departments. Chapter 11 discusses de-equitisation and Chapter 12 exit arrangements and dissolution. Chapter 13, perhaps appropriately, deals with litigation and, more optimistically, how to avoid it.

Returning to the beginning, it has to be accepted that managing a successful firm is a time-consuming business which reduces the ability of those managing to undertake fee-earning work. It is for this reason that partnership agreements are often neglected for too long. The question then arises as to whether or not there are mechanisms which can be put in place to deal with possible future events without the necessity for major revision of the partnership agreement, and this is discussed in Chapter 14.

Part 2 contains case studies, examples and outside opinions on specific topics raised in Part 1.

About the author

NICHOLAS WRIGHT is chief executive of Wright Son & Pepper, which has been in Gray's Inn, London, for approximately 200 years. The firm's main areas of expertise are in commercial, private client, partnership and regulation law.

Nicholas has specialised in partnership and professional regulation for over 15 years and has been a member of the Solicitors' Assistance Scheme for most of that time. He has acted as receiver and assisted firms in professional difficulty in an orderly winding up of their activities at the request of the Law Society. He has acted for a number of substantial firms in dealing with regulatory issues, as well as dealing with drafting, restructuring issues and disputes.

Nicholas is, with Victoria Wright, the editor of that part of *Cordery on Solicitors* (Butterworths, 1995) which deals with practice structures.

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Nicholas Wright
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