

Partnership Agreements

Should we have Partnership Agreements? Surprisingly perhaps, many firms do not have Partnership Agreements but simply operate Partnerships at will and many of the firms which have an Agreement find that it is hopelessly outdated, in draft or not signed by all the partners. Certainly it is often the aim of young solicitors to see their names on the firm note paper and that may cloud their rational judgement on the question of the content of Partnership Agreements. When partners fall out they tend to do so in a fairly acrimonious way and one of the main purposes of a Partnership Agreement can actually be to regulate disagreements however, it is not necessarily the most useful way of setting out the business structure. A partnership is an association of individuals coming together with the aim of working together hopefully to their mutual advantage. Partnerships can cover a variety of situations and in the legal sphere will cover anything from a two partner county practice to the giant city firms of the Scottish legal profession. Recent times, however, have seen more dissolutions, mergers, takeovers and fall outs than ever before and most readers will be aware of situations where the absence of a formal Partnership Agreement executed by all of the partners has been disastrous. The diversity of content of Partnership Agreements within the legal profession must be enormous but there is actually very little way of ascertaining the true diversity of their content. It is doubtful if anyone would ever be able to complete a survey of contents of Partnership Agreements within the legal profession. Asking a firm to disclose the terms of their Partnership Agreement is almost tantamount to asking them to breach the Official Secrets Act.

This paper can really do no more than highlight the areas which firms should consider encompassing in their Partnership Agreements and matters which new partners should be looking for in any Partnership Agreement put to them. It is not truly a management device. A Partnership Agreement may lay down a hierarchy and a basic management structure but it should not attempt to be a fully developed management device. Management is about reacting to and creating situations and a document which once signed is probably stuck away in a safe for a number of years is not the place to be doing that.

The general areas which tend to be covered by Partnership Agreements are as follows:-

Identity of Partner

Perhaps the most obvious starting point is to identify the existence of the current partners, however, paradoxically this is often a glaring omission. Frequently the Agreement is out of date and has not been revised to take account of resignations, retirements, assumptions, etc. This omission can often lead to difficulties both as to validity, enforceability and applicability of the Agreement.

Classes of Partner

It is helpful to identify the different status of partner who may be salaried, equity, profit sharing or limited under the Limited Partnership Act 1907 as the case may be. This clause allows for maximum flexibility and progression within the partnership and also caters for the opposite end when people may wish to retire. Variables here

are Profit Sharing Partner, Equity Partner (distinct from Profit Sharing Partner, this class actually has a share in the assets of the firm), Salaried Partner or Limited Partner.

Assumption of Partners

This may provide for an initial probationary period of new partners so that they remain on salaries for an initial period before being introduced to profit sharing and may also introduce a form of sliding scale for sharing of profits, gradually bringing a new partner up to full profit sharing basis.

Expulsion - How to deal with the errant partner

Partnerships, like marriage, are often for life but unfortunately an increasing number break up, and not necessarily in the friendliest of ways. It is, therefore, often prudent to provide for the mechanism of dissolving the partnership. It may seem odd talking about the dissolution of a partnership which is only in its infancy, but you may come to regret it if you do not. This also overlaps with the next heading.

Death, disability or resignation

Provision should be made for a period of notice to be given by a partner resigning from the partnership or notice by existing partners to a partner who is by reason of ill health perhaps no longer capable of contributing in the way that he or she once did. There should also be a provision for paying out the partner. These provisions are somewhat of a damage limitation exercise so as not to cripple the partnership financially and can also contain provisions designed to protect the firm client bank. What is a reasonable provision for one partnership may not be for another, particularly where there are a number of partners of around the same age, likely to retire over a fairly short time span.

Ownership of firm's assets and capital accounts

One often finds that in older practices perhaps the senior partner or partners own the heritable property which the firm uses and there may be provision in the Partnership Agreement for payment of rent to the senior partner for the premises.

There may be provision for certain of the partners to hold the heritable property as trustees on behalf of the firm. The question of the partners' capital accounts and interest thereon also falls to be discussed under this heading and this is a matter on which the profession should not hesitate to contact their accountants for their advice. If there is great disparity between the respective capital accounts of the firm then it would only be equitable that interest should be payable but equally there should be some specific agreement regarding interest or there being no interest. Perhaps provision should also be made for interest to be payable by a partner should his or her capital account become overdrawn. In days of falling profits this is by no means something that is unheard of.

Ownership of clients files

These will be basic anti-poaching provisions. The Law Society has provided guidelines as to what is acceptable procedure when a firm separates with the view to advising clients of the split up. There would be no harm in these provisions being repeated to avoid argument. It is after all easier to sit down at the outset when everyone is on speaking terms rather than try to thrash something out in the heat of an acrimonious dissolution.

Disputes

These are always going to occur in firms and the Partnership Agreement may provide for a certain voting structure with additional voting rights in proportion to seniority or capital invested in the firm. It may even provide a referral of certain disputes to an outside body such as the Faculty of Advocates. However, there are now a number of firms which have expertise in acting for firms and individual partners in areas of dispute.

Outside Activities

Solicitors as men and women of business often develop outside interests and there is a fairly healthy number in the legal profession who side step into politics. The Partnership Agreement may provide for a specific ban on outside activities or may give approval to certain prior activities before a person is assumed or may state that such activities can only be undertaken on approval of the partnership. For protection of the majority of partners it may also be appropriate to include a provision whereby the partnership can insist on the outside activities stopping if those activities are interfering with the partner's ability to perform his or her work satisfactorily.

Maternity Leave

As the number of lady solicitors continues to increase, this is a matter which is gaining more prominence. The partnership may feel that provision should be made for female partners to allow them a specific length of time off whilst having a baby and for an abatement of profits during that time. Once again it may be a case of it being better to stipulate in the Partnership Agreement what the situation will be rather than waiting until the situation arises when everyone feels too embarrassed to put limits on the situation. Provision should be made for paternity leave.

Profit sharing and - heaven forbid, loss sharing

This is, perhaps, the one question which is of most importance to new partners. Is the profit sharing to be per capita, on a percentage of the profits, on a sliding scale according to seniority, as a percentage of their capital account or in proportion to their fee output in relation to the firm's fee output as a whole? There are arguments for and against each system and it is really for individual firms to decide which basis suits them best. Some methods can be unfair to partners who either contribute in terms of fee income to a greater degree than other partners or conversely to those who produce

a lesser fee income simply because the quality of work which they are doing is less remunerative.

Management of the practice

The Partnership Agreement may appoint a partner as Managing Partner and provide for committees to deal with specific matters, or it may simply state that the management of the firm shall be undertaken as from time to time to be agreed, with an office practice manual dealing with the nitty gritty.

The Premises

This clause is important in view of the various arrangements which partnerships enjoy or endure in respect of the business premises. Irrespective of whether the property is leased, owned or a combination of both, this is an important clause and is very significant in the event of dissolution. The clause is particularly important where the premises from which the business is occupied or part thereof is owned by one or some rather than all of the partners. This clause should also carefully reflect how the business premises are treated within the balance sheet. In short, there should be no ambiguity as to the ownership of the premises and any interest in those premises when a Partner is assumed or leaves the firm.

The Accounting Period

This is perhaps now less important than previously given the general trend towards current year assessment, however, given the topical subject of work in progress and changes from a cash accounting basis, there may well be savings made or indeed expenses incurred in the event that the accounting period requires to be adjusted. In any event, it is always prudent to identify what is the appropriate accounting period, eg. On the questions of assumption, resignation, etc.

The Bank

This clause should do no more than identify the bank or banks with whom the firm has its office and various client accounts.

The Accountant

Again, it is appropriate for the accountants to be identified and in particular what role, if any, they may play in the event of drawing financial statements particularly in relation to the assumption or departure of partners. Of particular interest is whether and in what circumstances certificates or financial statements drawn by the accountants are final and conclusive.

Voting

Usually it is appropriate here to have management and administration of the firm by consensus but in contentious or unusual issues, sometimes it is inevitable and unavoidable that a vote requires to be taken. Clearly issues of that nature should be kept to the minimum but where they do prove to be inevitable, the voting structure

should be clear and make arrangements for any weighting and in particular what should happen in the event of a tied vote.

Pension, Life Assurance PHI etc.

These arrangements would normally be recorded perhaps in a number of clauses and notwithstanding they generally appear in Partnership Agreements, their effectiveness is of doubtful merit. These arrangements require to be policed (perhaps by the firm's accountants) to ensure that partners not only sign up to making adequate provision in the event of ill health retirement, etc. But that they actually carry through the commitment. Many partnerships have fallen foul of the situation. The agreement often makes adequate provision in terms which however clearly has not been carried into practice.

Motor Vehicles

The bete noire of many firms but again this is something which ought to be addressed and a clear statement should be made as to whether the vehicles belong to the firm or are personal and in the event that they are personal, which arrangements are made for legitimate business use.

Restrictive Covenant

Generally the trend has been away from this type of clause by reason of difficulties over enforceability. Perhaps a more cogent reason against is the idea that if a partner wants to leave there is little point in handcuffing him or her to stay. A restrictive Covenant - carefully drafted, however, can be an extremely useful tool in the negotiations which are undertaken at the time of the partner's departure. The other important aspect here is the question of impact of the European Convention on Human Rights. The suspicion has to be that Covenants are going to become much more difficult to enforce.

The Accounts

The purpose of this item appearing in the Partnership Agreement is to ensure that the Partnership Agreement is in accord, where appropriate, with the items referred to in the firm's accounts and in particular such things as goodwill (whatever that might mean in individual firms), work in progress, debtors, etc. Reflect the same treatment both in the Partnership Agreement and in the accounts.

Profits and Drawings

These are items not usually reflected specifically within the confines of a Partnership Agreement. Certainly drawings are rarely referred to in detail, however, whether within or outwith the agreement, it is important that some formal minute is kept of the entitlement and any variations thereof.

Miscellany of Ideas

1. The incoming partner
2. The salaried partner
3. The profit sharing partner
4. The equity partner
5. The female partner
6. The probationary partner
7. The expelled partner
8. The retiring partner
9. The Cash Room Partner
10. The Client Relations Partner
11. The Management Partner

Of necessity, the foregoing are only a selection of topics which could be incorporated into the Partnership Agreement. Tastes and styles will vary enormously, the essential point is that to avoid the vagaries, hardship and certain heartache upon dissolution as regulated by the 1890 Act, it is wise to have the appropriate agreement in place. All readers of this page will be aware of colleagues who have fallen foul of the partnership at will.

Summary

This paper can do no more than point at areas of concern and possible pitfalls in any Partnership Agreement. It is often the case that Partnership Agreements do not receive the amount of discussion they should, considering that they form the basis of most of our working relationships. The Partnership Agreements can last but a few months or a working lifetime. Prospective partners should be wary of being bullied into accepting conditions dictated to them on a take it or leave it attitude from senior partners. Prospective partners should remember that they are not being asked to join a partnership to make up the numbers. They have negotiating power and they are of value to the firm otherwise they would not be invited to be assumed. Prospective partners should not be afraid to seek advice on the terms of any partnership proposed to them. Indeed, prospective partners should always have sight of previous accounts before agreeing to anything; would you advise a client to purchase a house without a survey report! On this particular point do not take no for an answer; if the existing partners are unable or unwilling to let you have sight of previous accounts, ask yourself why. It is difficult to come up with a valid reason but easy to think of all the

wrong reasons. For advice, why not contact your local Council member and ask him or her to advise or to suggest someone else who might advise you. A senior member of the local faculty, a senior colleague or Council member would, in most cases, be happy to assist.

When you draw up a Partnership Agreement for your clients you are doing your best to avoid the partnership ending up in court in dispute and you should at least allow yourself the same considerations for your own working career.

Points to Remember

- Prepare a partnership agreement and ensure it is signed by all partners.
- Allow for expulsion of a partner.
- Define the ownership of the firm's assets and capital account.
- Define ownership of client files.
- Define the procedures for resolving disputes.
- Be specific with regard to outside activities.
- Define maternity arrangements for female partners.
- Define profit or loss sharing.
- Allocate the management of the practice to individuals or committees