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Craft a Proper Partnership Agreement Now

By Michael Downey

One of the most important tools for managing law firm risk is a properly tailored and updated partnership or operating agreement. Such an agreement can provide ready answers before major disagreements can arise between law firm owners.

Unfortunately, many law firms have no agreement, or an existing agreement is obsolete or incoherent. A bad partnership agreement, or no agreement at all, may require court intervention to decide issues the partners could have decided earlier and at far less cost.

Instead of waiting for problems to arise, I encourage you to spend time and resources now making sure that you have a good, current, suitable partnership agreement. If you are going to adopt or update a law firm partnership agreement, listed below are 10 topics that deserve particular attention.

Governance. Often law firms divide authority and decision making among four constituent groups: individual partners, firm managers, a management or executive committee and the whole partnership (or majority thereof).

In preparing or revising your partnership agreement, you should consider which group should have the power and obligation to make significant decisions and actions. For existing firms, you also want the agreement to track reality: inconsistencies invite litigation, as partners seek to use inconsistencies in language or course of conduct to gain unwarranted advantages.

Notice of problems. Often law firm management wants and needs to know promptly if someone at the firm is in trouble, perhaps facing a malpractice claim, sanction or disciplinary complaint. Establishing notice requirements in a partnership agreement helps ensure partners give proper notice—or suffer clear consequences when they do not.

Compensation. Many partnership agreements detail how profits will be distributed. If your agreement contains such language and you want to keep it, make sure current practices track what the agreement says, so a disgruntled partner cannot use an inconsistency to seek additional compensation.

Alternatively, many partnership agreements only identify who will determine partner compensation. The exact method used for dividing profits may actually be left to a compensation committee or follow guidelines or a formula set forth in some other document. Using a separate document may allow greater flexibility should the firm wish to modify its compensation system.

Outside opportunities and activities. Partner disputes and partnership problems often originate from partners' outside opportunities and activities. May a partner

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serve on a for-profit corporate board and keep board compensation? May a partner keep a gift of a client's valuable stock or services, even when the client owes substantial money to the firm? May a partner spend substantial time on outside activities but still expect equal treatment in compensation decisions?

The partnership agreement is often the best place to establish expectations and thus avoid problems relating to client gifts, board positions and lawyer moonlighting.

Accessing firm information. State law often guarantees a partner may inspect a firm's books and records upon demand. A disgruntled partner's demand to inspect records may disrupt a firm's operations. The partnership agreement can minimize disruption by establishing what can be inspected and how, when and where the inspection must occur.

Confidentiality. When preparing a law firm partnership agreement, I regularly include a provision designed to protect the confidentiality of the firm and the firm's clients. Such a confidentiality provision should specify a clear remedy when, for example, a partner considering leaving the firm decides to share a firm's financial data when seeking employment with a firm competitor.

Partner withdrawal and termination. Partner departures may cause significant strain on a firm. A partnership agreement can reduce that strain by providing clear procedures that minimize disruption and protect the interests of the clients, the firm and the departing partners.

Firms should also have a quick, clean method for terminating partners whose misconduct threatens the firm and its reputation.

Attorney fees when lawyers leave. Most litigation following law firm divorces relates to how attorney fees will be divided for work performed both by the firm and by the departing lawyer. You can minimize these problems by including methods for identifying what fees will be shared and what the firm and departing partner's shares will be.

Dispute resolution. Partner disputes sometimes last years longer than a law firm partnership did. To avoid such conflicts, include a dispute resolution provision that ensures swift resolution, even if the results may involve a bit of rough justice. My favorite is the so-called baseball arbitration provision, which allows an arbitrator only to choose a resolution from among those proposed by the disputing parties. The process is intended to encourage parties to be reasonable with their demands, and offers a quick, final resolution of the dispute.

Indemnification. Finally, partnership agreements should contain indemnification provisions that protect firm managers should they be sued for actions they take on behalf of the firm. Firms may also want to ensure the firm is indemnified should a partner's outside activities cause the firm to incur legal or other expenses.

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