

WHEN YOU SAY 'I DO'...

UNDERSTANDING PARTNERSHIPS IS AS CRUCIAL UPON ENTRY, AS IT IS UPON EXIT, SAY CLARE MURRAY AND SUSANNE FOSTER

Practices and partners have faced difficult times in the past two years. And many have no doubt encountered awkward situations that have placed unrelenting strain on their practices, as well as their future career prospects.

But there are some key issues that they need to familiarise themselves with, so that they're better placed to deal with the challenges facing the modern-day accountancy partner in these uncertain economic times.

DUE DILIGENCE FOR LATERAL-HIRE PARTNERS

Partners will often not be afforded the opportunity to review the partnership agreement before accepting partnership with a new firm. But a partner should understand, as far as possible, their potential exposures and liabilities before signing on the dotted line. This they can do by offering to sign a confidentiality agreement, if the firm is reluctant to let a copy of the partnership agreement out of their sight.

Consider the following before accepting a lateral-hire move:

- Starting point – ask for and review a copy of the partnership or members' agreement.
- Request a copy of the accounts for each of the last few years, and details of the financials for the current year and performance against any budgeted figures.
- Understand the profit-share structure. Is any element of the profit-share discretionary, and if so, who decides on this discretionary allocation and what criteria and process apply?
- Be aware of the extent of your potential exposure to liabilities, for example, consider whether the firm is an LLP or general partnership; are there any major liabilities for which you may become personally liable as a partner or guarantor (eg, existing or new premises, bank funding and annuities for retired partners)?
- How much capital are you being asked to contribute? How capitalised is the firm? Have there been any recent capital calls? How quickly can you get your capital out on exit?
- How are key strategic decisions of the firm taken generally (including on partner exits) – by an executive committee, or the partners collectively?

You should also establish on what grounds and with



what vote and process you can be removed (with or without cause); and what financial entitlements and obligations will apply to you both before and after retirement?

TRUE PARTNERSHIP: WHAT IF A FIRM GETS THIS WRONG?

While you may be held out internally as a partner, it is critical when assessing any legal protections you may have, to work out whether you are a genuine partner or an employee of the firm.

Employees, unlike partners, have unfair dismissal protection, so if the firm tries to remove you, they would need to have a fair reason and follow a fair process in order to avoid a successful unfair dismissal claim (where loss-based compensation up to £65,300 can be awarded by an employment tribunal).

Employees are protected by whistleblowing legislation, while partners in a general partnership are not covered. But it remains untested by the courts as to whether LLP members are protected by such legislation.

Genuine partners do not automatically have family-

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friendly rights, such as maternity and paternity leave (while employees do) although partners are still covered by statutory discrimination legislation on the ground of sex (as well as race, age, disability, religion or belief and sexual orientation etc).

Unlike most employees, genuine partners in a general partnership owe a duty of good faith between each other, and usually from LLP members to the LLP itself. In essence, a partner must act in the best interests of the firm. A breach of this duty could result in the partner or LLP member having to account for profits unlawfully earned as a result of any breach.

Relevant factors as to whether you may be a genuine partner include whether you:

- participate fully in the profits and losses of the firm subject to any limited liability protection that may apply;
- are required to make a capital contribution;
- share in the surplus assets on a winding up;
- have the right to hire and dismiss employees; or
- have authority to sign cheques on behalf of the firm.

If you are a genuine employee, then on departure, your firm should follow certain disciplinary and grievance steps under employment law. Failure to comply with such procedures may be taken into account when an employment tribunal assesses the overall fairness of your dismissal. The tribunal has the discretion to increase any subsequent awards made against the firm by up to 25% if the firm unreasonably fails to follow such procedures. Failure to follow procedures in a discrimination case, where a partner is in fact an employee, could be financially damaging for the firm (awards for discrimination are uncapped, unlike any unfair dismissal award).

CONSIDERATIONS UPON EXIT

On exit, a partner may be asked to sign a retirement deed, to record the terms of departure and to receive any enhanced payments. Careful thought should be given in those retirement discussions to issues such as:

- the actual right of the firm to remove the partner and the majority required;
- if and when capital is to be repaid;
- payment of profit share and release of tax reserve;
- indemnities that will apply post-retirement;
- whether any compensation should be paid and legal fees reimbursed.

Other issues that need to be considered relate to the partner's position and rights, including the potential breach of the duty of good faith, breach of the partnership agreement, and discrimination claims.

RESTRICTIVE COVENANTS

Restrictive covenants are a means by which a firm can limit a partner's activities once they have retired from their firm so as to protect the firm's business from

damage caused by a partner's departure.

The starting point with partner restrictions is that they are viewed as a restraint of trade and contrary to public policy. However, they will be enforceable if they protect a legitimate interest of the firm (eg, the firm's business connections or stability of its workforce) and go no further than reasonably necessary to safeguard those interests. It is important to bear in mind that a separate body of restrictive covenant case law has developed in the partnership context and partner covenants are far more likely to be found binding on a partner than an employee, even if they are longer in duration than those found in the employment context.

Typically, partner-restrictive covenants are between one and two years in duration (unlike six to 12 months for employees) and prevent the partner from soliciting clients and staff and dealing with clients. Obviously this is not ideal for a partner on the move – as a partner you should consider asking for any restrictions to be waived or at least varied to improve your prospects of securing a role elsewhere. Also consider if there is any basis for challenging their enforceability. Further, on moving to a firm, you should consider requesting a carve-out for any clients you bring with you from another practice – although this might be resisted.

DEFAULT RETIREMENT AGE

In July 2010, the Court of Appeal, in the partnership case of *Seldon v Clarkson Wright & Jakes*, upheld an employment tribunal's decision that the forced retirement of a partner at 65 was unlawful direct age discrimination, but it was found to be a proportionate means of achieving a legitimate aim.

However, it remains the case that each firm will have to be able to justify any compulsory retirement age in their particular circumstances. Given that government intends to remove the default retirement age (DRA) of 65 for employees later this year, the issue of whether it is truly justified for each partnership in its individual circumstances to have a retirement age will be scrutinised. This is especially so given that firms will be unable to point to the DRA to back up their contractual retirement age. Therefore while *Seldon* gives firms some comfort, it is not the universal panacea that has been suggested. Partners nearing retirement should take advice early to understand their position if they wish to delay their retirement.

CONCLUSION

The above points are not exhaustive, but give a starting point as to the issues partners should think about. While partnership brings with it benefits, it also brings potentially onerous liabilities and obligations. While economic stability remains uncertain, it is more important than ever that partners are fully clued up on their potential rights and exposures.



Clare Murray is managing partner and Susanne Foster a senior associate at CM Murray LLP. For more on this topic, visit the website and download the *Little Book of Partnership Law* at www.cm-murray.com