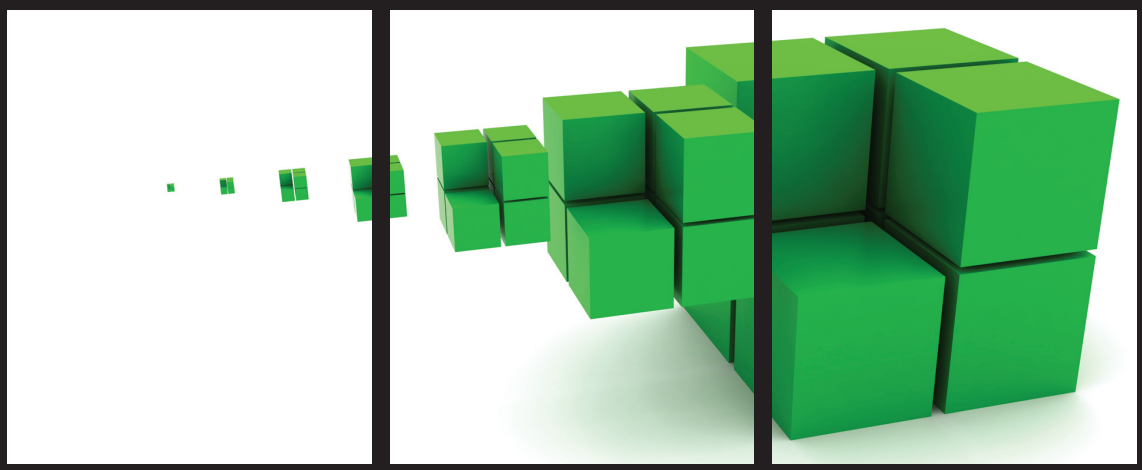
LLP Conversion for Law Firms

NICHOLAS WRIGHT



PUBLISHED BY ark GROUP IN ASSOCIATION WITH mp managingpartner

LLP Conversion for Law Firms

is published by Ark Group

UK/EUROPE OFFICE
Ark Group Ltd
Paulton House
8 Shepherdess Walk
London N1 7LB
United Kingdom
Tel +44 (0)20 7490 0049
Fax +44 (0)20 7324 2373
info@ark-group.com

NORTH AMERICA OFFICE
Ark Group USA
4408 N. Rockwood Drive
Suite 150
Peoria IL 61614
Tel +1 309 495 2853
Fax +1 309 495 2858
publishingna@ark-group.com

ASIA/PACIFIC OFFICE
Ark Group Australia Pty Ltd
Main Level
83 Walker Street
North Sydney NSW
Australia 2060
Tel +61 1300 550 662
Fax +61 1300 550 663
aga@arkgroupasia.com

Assistant editor
Stephanie Ramasamy
sramasamy@ark-group.com

Commissioning editor
Anna Shaw
ashaw@ark-group.com

Managing director
Jennifer Guy
jguy@ark-group.com

UK/Europe marketing enquiries
Robyn Macé
rmace@ark-group.com

US marketing enquiries
Daniel Smallwood
dsmallwood@ark-group.com

Asia/Pacific marketing enquiries
Steve Oesterreich
aga@arkgroupasia.com

ISBN: 978-1-906355-87-6

ARK1346

LLP Conversion for Law Firms

NICHOLAS WRIGHT

PUBLISHED BY ark GROUP IN ASSOCIATION WITH mp managingpartner

Contents

Executive summary

FOR DECADES, if not centuries, most solicitors in private practice have run their businesses either as sole practitioners or in partnership with other solicitors. Although a few solicitors have operated through limited companies or as limited partnerships, they have been in a very small minority. The Partnership Act 1890 simply codified, clarified and extended the existing law.

This long history has enabled practitioners to draw on a considerable pool of experience and knowledge when dealing with their partnership affairs. The old system of practising law was based on personal responsibility and integrity, reinforced by the principle of unlimited liability. The rules of conduct governing solicitors were based on these principles, as were the various solicitors' acts. Even the Legal Aid and Advice Act 1949 and many of its subsequent re-enactments assumed that an individual-conducting solicitor would have responsibility for each matter.

The landscape has changed dramatically for solicitors in recent years in two ways. First, the Limited Liability Partnerships Act 2000 permitted the creation of limited liability partnerships (LLPs). Second, the Clementi report reinforced the government's determination to open up the business of providing legal services so that it was no longer restricted to those, such as solicitors, who were expected to act as professionals rather than businessmen. As a result, we have the Legal Services Act 2007 which, together with its ongoing regulations and amendments, has already permitted the introduction of Legal Disciplinary Practices (LDPs). These allow limited external financial and management input into firms, and will enable the creation in the near future of Alternative Business Structures (ABSs).

As a result of these changes, it has been necessary, not only for the Law Society to divest its regulatory powers to the Solicitors Regulation Authority (SRA), but also for the SRA to undertake a complete revision of the rules governing the conduct of solicitors. The Solicitors' Code of Conduct 2007 made fundamental changes to the rules and was heavily amended in 2009 to deal with the new structures. The emphasis of these rules is now in the perceived risk posed to the consumer of legal services, and the penalty for a breach is the primary responsibility of the firm, although of course all partners and those held out as partners had – and still have – liability for the acts and omissions of those within their firms. For example, under the old rules a solicitor of at least three years' standing, with a current practising certificate, had to attend each office of his/her firm at least once a day when it was open to the public. If he/she did not, then he/she was in breach of the rules. His/her partners might also be in breach for failing to ensure his/her compliance with the rules. The Solicitors' Code of Conduct 2007 requires no such attendance, but instead, demands that auditable procedures are in place to ensure adequate supervision of that office. If something goes wrong,

then the presumption would be that the auditable arrangements for supervision must have been inadequate, even though the supervision requirements are not spelt out in the Solicitors' Code of Conduct 2007.

On 17 March 2010, the Chairman of the SRA confirmed that, in order to accommodate the new structures, there would be a complete revision of the Solicitors' Code of Conduct 2007, that this would apply to all firms whether or not they were becoming LDPs or ABSs, and that the new Code would be enforced from 6 October 2011. The purpose is to allow the new entrants into the legal field to be able to compete on equal terms and to allow the market to decide on who will survive.

Since the Clementi report and the Solicitors' Code of Conduct 2007, there has been a resultant and continuing tendency for smaller firms to join together in order to create organisations of sufficient size to enable them to afford the bureaucracy necessary to comply with the new Code and with other legislation, such as the Proceeds of Crime Act 2002. Many firms contemplating such mergers or the introduction of outside finance or expertise that might be available to them as LDPs or ABSs, would not feel comfortable in entering into a partnership because of the unlimited liability for the acts of other partners that follows from it, but would be prepared to enter into an arrangement in which the risks and rewards are perhaps more closely matched.

Therefore, one of the many reasons that partnerships give for converting is the strain of complying with the ever-increasing burden of bureaucracy imposed upon them by the government and by its regulators. Apart from the potential for merger or increased investment from outside, many firms consider that the LLP structure, being more corporate in design, is more suited to the modern world of regulation and audit trails. However, the work involved in converting is substantial.

The purpose of this report is to examine the strategies firms are taking to meet the demands of the changing legal market, to give the reader the information necessary to make an informed choice as to whether to convert or not, and to set out the process by which a conversion may be successfully achieved and built upon. And if your firm has already converted to an LLP, then you might want to consider revising your agreement in case there have been any oversights in the drafting process which could potentially impact the firm and its members. It may well be the case that your firm has converted using the default provisions, wherein lies hidden dangers which firms need to be aware of.

Chapter 1 deals with conversion of a partnership into an LLP as distinguished from setting up a new business, and looks at the trends of converting to an LLP.

Chapter 2 examines the advantages and disadvantages of converting from a partnership to an LLP.

If and when a decision to convert is made, there is a significant amount of preparatory work which needs to be thought about and organised. For example, many partnerships do not even have in their partnership agreement the power to convert. These issues are addressed in Chapter 3.

Chapter 4 covers the practical issues involved in forming the LLP. Fairly obviously, the LLP will need to be formed before the partnership can be converted into it, and it is therefore logical to assume that the LLP agreement will be in place at the time of formation. This is, however, not strictly the case as it is possible to form an LLP using the default provisions in the LLP Act 2000.

This is not generally to be recommended as the default provisions have a number of serious flaws, as some solicitors have found to their cost.

Because of the dangers which may be present in the default provisions, and the lack of case law to clarify the uncertainties, it is prudent for any firm, even if it is intended to have a bespoke agreement, to know what these provisions are and the potential problems they may cause. Chapter 5 discusses the default provisions and their drawbacks in some detail.

Every firm is different and each LLP agreement needs to reflect that firm's intentions. Because there is no generally-accepted standard for LLPs, each provision needs to be tailored to the particular firm and its needs, and clauses in existing partnership agreements have to be carefully examined to ensure that they are suitable should it be desired that they are transferred to the LLP agreement. These issues are examined in Chapter 6.

Even when all the preparation has been completed, there is still the practical issue of transferring the existing partnership business into the LLP. This is not simply a transfer of business. The partnership will have clients with ongoing matters and those clients have a contractual relationship with the partnership which cannot be unilaterally transferred to another entity. These and other issues are examined in Chapter 7.

It was made clear by the government that LLPs were intended to be tax neutral when compared with partnerships. The general tax treatment of LLPs is addressed in Chapter 8 together with some practical issues that might arise following a conversion which, for whatever reason, cannot be carried out in a straightforward way.

Any firm contemplating conversion must decide what management and technical resources it has to manage the project and whether it is sufficient and a sensible use of the firm's resources, to allow the project to be run wholly within the firm or whether it would be better to outsource some or all of the conversion project to those with specialist knowledge. This question is considered in more depth in Chapter 9.

Finally, any firm thinking about converting will need to consider what will happen when the new Code of Conduct and the right to operate as an ABS, come into force in October 2011. For example, an approved non-lawyer manager of an LDP is likely, under the new regime, to force the firm to become an ABS to remain compliant with the new rules. Firms will therefore have to consider whether to change structure now, in order to bed the firm down in its new guise as an LLP, or whether to wait to see how the new rules and structures will work in practice before making a move which may require a further change later on. This is discussed in more detail in Chapter 10.

The report features two law firm case studies highlighting the preparation before, and the transition to a conversion, and some of the common problems encountered before, during and after transition, as well as an illustrative example of an LLP agreement in the Appendix. A CD ROM containing relevant forms for an LLP conversion also comes with this report.

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, LLPs and regulation law.

Nicholas advises firms on LLP conversions, has acted as receiver and assisted firms in professional difficulty. 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 also editor of the 'Practice Structures Section' of *Cordery on Solicitors* (Butterworths 1995).

Nicholas can be contacted at: nwright@wsap.co.uk