

THE SUCCESSION ISSUE

The limitations of the partnership structure

The most popular vehicle for providing main stream legal services has traditionally been a professional partnership. This structure has inherent problems with respect to succession and the continuation or expansion of financing. Many practices have an ageing partnership profile with large capital accounts that require an exit route. In the past they have relied on the availability of younger professionals who could be eased into equity partnership to enable the older partners to release their capital. This strategy is proving difficult to maintain in the modern environment. Firstly, issues such as falling pension performance and second marriages mean that existing partners may want to work for longer thus blocking the entry of younger partners. Secondly, and more critically, younger partners tend to have limited debt capacity due to large amounts of student debt and high housing costs. Locking finance in a capital account is also very restrictive in terms of partner mobility, which is more of an issue for the younger professionals of today.

Legal Services Bill

The constraints of partnership are likely to increase the pressure for external investment in the future. The draft Legal Services Bill offers a possible option in the form of *Alternative Business Structures (ABS)*. The Law Society has given its support to the concept of *Legal Disciplinary Practices (LDP's)*, both internally and externally owned, which are two types of ABS. A LDP would allow non-

lawyers to be partners in entities providing legal services to the public, but the range of services provided by the entity would be no wider than is permitted for traditional solicitors' firms. The externally owned LDP, however, would allow for outside investment. Possible owners of such entities might be membership organisations, such as the AA or the RAC, retailers, in particular the large supermarkets, financial institutions and private equity houses.

External ownership and regulation

An obvious downside of external ownership is that it may lead to a relaxation of regulations or professional ethics or to conflicts of interest. Approved regulators will be required to address this issue. External owners will have to meet "fit and proper" tests. This will probably address areas such as honesty, integrity, reputation and financial soundness. Clear rules will also have to be provided to address the prospect of potential conflict of interest between an investor and a legal professional in particular cases and also to address the amount of influence that the investor is allowed over the firm's management. The Law Society have questioned the complex regulatory mechanism proposed by the draft bill, which they feel will require enhancement in the final Act.

Management of the LPD

There will be no requirement for a lawyer majority on the management group of an ABS, but it will have to

include a Head of Legal Practice (a qualified lawyer) and a Head of Finance and Administration (not necessarily a lawyer). In a small firm, they might be the same person. The Head of Legal Practice would be responsible for compliance with the Regulator's rules and for ensuring that services are provided only by those who are appropriately qualified. The Head of Legal Practice would have a duty to report any contravention of the rules and could not be removed without the Regulator's consent. The Head of Finance and Administration would be subject to a competency test in areas central to practice management, such as handling of client monies.

So is this the solution to the succession issue?

The new legislation will provide an alternative to the perennial problem of seeking additional capital and releasing capital already in the firm. Other professions such as investment bankers have in the past made the transition from partnership to externally funded corporate entity very successfully. It may be that legal practices will do the same. However, any existing partners seeking outside investment will need to look carefully at how their firm can attract investors. Private investors are likely to look for significant growth in the short term, an exit route, business stability, minimal dependence on individuals (who might be tempted to leave and take a large part of the business with them), and effective management with plans for expansion and succession. This may be a tall order for some firms, but may

be no more than a partner promoted from within would expect.

Conclusion

Legal practices face a more challenging future, with hopefully greater opportunities. Practices that currently have a number of partners nearing retirement age should start to plan for the future. Once the new legislation has been enacted, this may include looking at more diverse exit routes than the traditional equity partnership provides.

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