

## Chapter 4

# Business Structures

This chapter is about business styles. In a traditional sense, there are three to choose from: sole proprietorship, partnership or incorporation. For the purpose of this book, I have added the home office, associate practice and the purchase of a law practice as alternative choices. In any of these scenarios, the issue of incorporation is a viable consideration, but it will be dealt with separately in the next chapter.

### SOLE PROPRIETORSHIPS

As a sole proprietor, you are working strictly on your own, be it from an office in your home or in your own commercial office space. There are certain benefits to this style. You can operate your business under your full name, with “Barrister & Solicitor” underneath and avoid having to register a business name. You will have complete control over your expenses, your workload, your trust account and your revenue. There will be no need to consult others if you choose to expand your business or you choose to work a reduced work week and you have the freedom to work out of your home to keep your overhead to a minimum. Most importantly, you will not be incurring potential liability as a result of anyone else’s negligence or malpractice.

Sole proprietors have the option of renting space in what is referred to as commercial chambers. There, the lawyer is essentially sharing space, reception, some operating costs and, often, secretarial services with other lawyers or other business professionals but is not required to enter into an association agreement. In this situation, the possibility for incurring joint liability with other practitioners is virtually non-existent. If this sort of arrangement meets your needs, it may be a very economical approach. Beware of hidden costs that may be imposed on you as a tenant at the whim of the landlord or owner. Ensure that your lease agreement specifies that there will be no additional costs on your tenancy (known as a gross lease). Lawyers who are not in partnership may not share trust accounts.

### Negative Aspects of Sole Proprietorship

The negative aspects of sole proprietorship should be considered carefully. For many people, the isolation factor is extremely prohibitive. Many sole practitioners miss the ability to bounce ideas off their colleagues and obtain quick advice from other lawyers. There are no cross-referrals from office mates, and there is no sharing of advertisement costs, office equipment, letterhead, office supplies and other overhead expenses. Significantly, there is no one else on site to babysit your practice while you are on holidays. Practising alone is clearly not for everyone. One colleague who started out on his own right after the bar admission course tells me he felt like the Maytag repairman during his first three months of business. (The significance of that comment will only have meaning to those of us old

enough to remember the Maytag commercial about the lonely repairman who never got called for service because of the alleged indestructibility of the Maytag washing machines.)

However, on the brighter side, the Internet has opened many new avenues of communication for sole practitioners. For example, many criminal defence lawyers who are members of the Criminal Lawyers Association find the CLA list service (list serv) to be a valuable resource. The list serv is an Internet-based private chat line for defence counsel. The flow of information relates to many diverse topics such as local legal practice, judges, crowns, trial strategy and Legal Aid issues, along with the dissemination of important information for counsel who practice criminal law. If you have a question, posting it to the list serv often results in a plethora of advice from senior counsel. It is sometimes like a cyber replication of the sharing of war stories in the lawyers' robing rooms at court.

There are similar forms of online communication among members of family, civil and immigration law, to name but a few.

### Home Offices

Home offices are increasing in popularity, largely due to current economic conditions, the ability of some lawyers to construct a cyber practice and the increased price of doing business. The costs of running a law practice, rising insurance fees and cutbacks to the legal aid plans have made it more difficult than ever to remain profitable, particularly if you are balancing child care responsibilities with operating a business. Also, lawyers are discovering that a home office may be particularly well suited to certain types of practices. One example is wills and estates. Meeting in the comfort of a lawyer's home in a nice residential setting may be preferable to clients when they are dealing with such sensitive subjects as estate planning. Or, you could even offer to meet with clients in the privacy of their own home or office and use this aspect of your service as a marketing tool.

With a home office, even if you need to use a boardroom facility on occasion, it can be rented on a daily or even hourly basis. Reception services as well as secretarial and fax can also be rented on a pay-per-use basis. There is no reason why you can't reduce your overhead significantly with creative structuring of your business.

### Negative Aspects of a Home Office

On the other hand, a home office may not be practical for certain areas of law and, whether we like it or not, some clients will never retain you if you do not practise from a high-powered office in some large downtown highrise. With a home office, you can never escape to the office or from the office; there are always potential problems with client confidentiality in the use of the phone, computer and fax, and you need a lot of self-discipline to regulate your hours of work. Home office practitioners must be cognizant of by-law provisions, which may affect the proposed office site. Most cities have enacted by-laws restricting or prescribing the operation of a business in residential areas. Again, from a practical point of view, in some jurisdictions this by-law is not enforced unless the neighbours complain. It is best to consult with your

municipality before you set up shop. There are often specific issues regarding signage, parking and employees, which may complicate matters.

If you decide to operate from your home, you must remain cognizant of your obligations under the Rules of Professional Conduct and The Law Society Act. Your office must be structured so as to preserve client privacy, property and confidentiality. Some renovation work may be needed. There must be sufficient space to allow storage of confidential files and financial records. It will be necessary to restrict access to your office and certainly to control access to your computer, your files and any electronic client information. If family members are allowed access to the home office computer, it may be necessary to use password protection on your work files, segregation of client files or encryption of electronic files. Make all of the necessary inquiries and adjustments if you are planning to choose this route.

## ASSOCIATE PRACTICE

The idea of sharing space and overhead costs with other lawyers in associate practice is rapidly becoming more and more popular. The benefits are numerous. You maintain much of the autonomy of a sole proprietorship, liability is not shared (although this issue is somewhat qualified), there is the possibility of cross referral work, you have someone else on site to watch over your practice when you're on holidays or ill, you can share expenses with others, such as photocopier, fax, office supplies, advertising, reception services, administrative services, bookkeeping services, etc., and there is someone else there to lend a sympathetic ear when you have a problem. Importantly, you maintain your own bank accounts and thus your business from a financial standpoint remains separate and distinct.

### Associations Must Not be confused with Partnerships

Both the home office and associate practice are acceptable business structures from the point of view of the Law Society. However, there are some conditions. Lawyers practising in association must not hold themselves out to the public as a partnership or law firm. Our group of associated lawyers had letterhead and business cards reading "An Association, Not a Partnership". We had an unincorporated company that contracted our services and supplies. The company also employed our receptionist. Each lawyer was responsible to ensure that any personal expense was billed to that lawyer and not to the company or association.

It can be confusing if the telephone is answered using all the last names of the associates. An alternative we chose was to ask our receptionist to answer the phone with the greeting "Law Offices". The bottom line is lay people do not always appreciate the subtle legal distinctions between a partnership and an association. What a judge will look at are the visible indicia of your business relationship. If a creditor or client is operating under the mistaken belief that your association is a firm, it might be prudent for you to set the record straight, perhaps even in bold form at the bottom of your written retainer agreement.

## Negative Aspects of Association

Potential joint liability is one of the biggest detriments of associated practice. When all is said and done, you still may be held to joint and several liabilities with your associates. You can draft a mutual indemnification agreement, but, again, the bottom line is if one or all of your associates become insolvent or are personally judgment-proof, you may still be stuck paying for the jointly acquired debts. With a partnership, the members are personally on the hook for partnership debts and even work-related negligence. Should one of the partners leave the partnership, the remaining lawyers need to enter into a new agreement. There is the potential for ill will among the partners as profits are normally shared on a pro rata basis depending on the interest each partner holds in the partnership. One or more of the partners may feel that he or she is carrying the rest of the group. As the partnership grows, the job of managing this entity increases commensurately.

In fact, this did become an issue with our first association. One of the lawyers left the office, leaving the rest of us liable for his share of the joint expenses. Fortunately, we subsequently were able to find a replacement that alleviated the problem somewhat. We had to assume responsibility for the debt this person left behind, but the new associate was able to assume the financial share of the former associate until the expiry of our lease.

## BENEFITS OF PARTNERSHIPS

On the other hand, being a partner allows you the security of sharing in the joint profits of the combined work of the members. If you have a bad month or two or if you practise in an area such as real estate, which has its ups and downs, then being in a partnership may help you to ensure a more consistent source of income. Partners normally contribute financially to the capital of the partnership, so it may well be that membership in a partnership is more secure than an association where members are freer to leave at will. Because of the often large capital contributions of partners, a partnership may be more willing than associations to build equity by acquiring other permanent assets under an assumption of longevity of existence.

## THE LEASE AGREEMENT

Normally, landlords require personal guarantees from the individual officers if a company is going to hold the lease. More commonly it seems, landlords are requiring individuals to appear as parties to the lease. The same is true for some service and supply contracts. Accordingly, in some ways, associate practice may well be closer to the partnership model and its attendant liabilities. This is a very compelling issue you need to consider when choosing the people with whom you will be sharing expenses.

## CHOOSING YOUR BUSINESS ASSOCIATES

Choose your associates or partners carefully. These are not just business relationships; they are personal relationships requiring mutual trust and respect. There is much at stake. You

will have to work together closely. You will have to resolve differences of opinion. Operating a business is not simply cold impersonal balancing of numbers; rather, it involves moral dilemmas and lifestyle decisions. Make sure that the associates you choose are people you can trust and people for whom complete candour in business matters, financial and otherwise, is not problematic. As time goes by, communication may decrease or may stop completely as people change and priorities shift. It is like a marriage. You need to work hard to maintain communication with your partners or associates.

## THE COST-SHARING AGREEMENT FOR ASSOCIATES

It is advisable to enter into a written cost-sharing agreement with your associates. Specify a finite term of the arrangement. At the end of the term, you can agree to extend it if it is working or terminate it with no hard feelings. Provide for the means by which someone can leave the association early and how they are to be compensated if at all for their contribution to any joint assets. Specify the period of notice that must be provided by the departing member. It is also important that a mechanism for the removal of a member be included and specify under what circumstances this action may occur. An individual should be nominated to find a replacement associate under both circumstances and it should be specified who bears the interim expenses if there is a delay between the departure of a member and the introduction of a replacement.

In your agreement, specify who has contributed to the assets of the association. Items such as fax machines and other office equipment should be included on the list if they were purchased or donated by one member. Provide for the shared purchase of equipment or furniture. Who owns it after the association terminates and how is the value to be redistributed?

If there is unequal use of shared facilities, it may potentially cause problems if not discussed in advance and/or dealt with in the cost-sharing agreement. The potential for conflict could arise in the situation where support staff is shared. Try to determine in advance what each member will need in terms of administrative support. At this time, it might be wise to draft job descriptions for any contemplated support staff. Set out which tasks are to be allocated to the staff member(s) and include the specific needs of each associate. Talk about how conflicts will be resolved before they occur. It is much easier this way.

Delineate the various business-related tasks to be performed by the members, and discuss how jobs are to be allocated. An important role is the supervision of support staff. We found out the hard way that no matter how competent employees are, they must be supervised. Employees should not be subjected to more than one authority; otherwise, situations may arise with potentially conflicting instructions. Someone should be designated office manager, someone else should be in charge of the association bank account and attendant record keeping and another should be responsible for payroll. If the administrative workload is unequal, then talk about rotating tasks.

Your cost-sharing agreement should specify how the telephone is to be answered, in whose name the lease is to be engrossed, who owns jointly purchased assets, which

insurance costs are to be shared, whether there should be monetary compensation paid to members performing management duties and which items should be included as “common expenses”. You should also consider the practicalities of restricting the nature of each lawyer’s practice or specialties to avoid potential conflict among the members.

#### MANAGEMENT COMPANY

If required, you can incorporate a management company to hold the lease (if the landlord is willing), employ the staff and enter into contracts. It is a good idea to do this if you are planning on running all of the group expenses through the company. Remember, though, that in order for each lawyer to take advantage of the HST paid on supplies and services by the company, the company will have to be an HST registrant and submit quarterly returns. It will cost you to incorporate the company and you will have to keep corporate books and file an annual corporate tax return. Be sure that the benefits of incorporating your management company outweigh the costs, including the time you will spend in administering the company business.

#### HAVE REGULAR MEETINGS

Associates should meet regularly, especially at first to sort out recurring problems and to identify needs in advance. Our group did not observe this ritual at first and I think we all paid dearly for a disorganized office. Our bills were not getting paid on time and there were problems with service and supply orders that were not being caught quickly enough. When we began meeting weekly, the lines of communication were much clearer and we spent much less time managing the office.

#### WILLS/POWERS OF ATTORNEY

You should give some thought to requiring all associates or partners to make out a will and/or a power of attorney. While we don’t like to think that any of us will ever become incompetent or unable to manage our affairs or, worse still, die, it may be advisable to have something in place for just such a contingency. Choosing someone you trust to have signing authority over your bank accounts if anything happens to you benefits not only you but your associates as well. Discuss who will assume responsibility for the administrative tasks of the association should someone become ill or absent for an extended period. Don’t wait until it happens to make contingency plans.

#### UPDATE YOUR COST-SHARING AGREEMENT ANNUALLY

Your agreement should be updated as your association grows and/ or changes. If you can, try to cover all the bases before the office opens, while there is an abundance of goodwill and candour among you. If you have problems later on, this situation may not remain the same. The last thing you want to be doing in your first year of practice is fighting with your associates.

## LIMITED LIABILITY PARTNERSHIPS

THE LAW SOCIETY ACT AT SECTION 61.1(1) allows as follows:

- (a) two or more persons who are licensed to practise law in Ontario as barristers and solicitors may form a limited liability partnership, or continue a partnership as a limited liability partnership, for the purpose of practising law in Ontario;
- (b) two or more persons who are licensed to provide legal services in Ontario may form a limited liability partnership, or continue a partnership as a limited liability partnership, for the purpose of providing legal services in Ontario;
- (c) one or more persons who are licensed to practise law in Ontario as barristers and solicitors and one or more persons who are licensed to provide legal services in Ontario may together form a limited liability partnership, or continue a partnership as a limited liability partnership, for the purpose of practising law and providing legal services in Ontario;
- (d) two or more professional corporations may form a limited liability partnership, or continue a partnership as a limited liability partnership, for the purpose of practising law in Ontario, providing legal services in Ontario or doing both, as authorized by their certificates of authorization. 2006, c. 21, Sched. C, s. 93.

It would be advisable to review the provisions of the Limited Partnership Act RSO 1990 C. L. 16

This business style involves the signing of a partnership agreement, registration of the name of the partnership, joint and several liability among the partners, sharing a trust account and a single line of credit and usually incorporating a management company. It shares many of the benefits and detriments of associate practice.

The above sections make it clear that limited liability partnerships can be formed between corporations, between lawyers, between paralegals or between lawyers and paralegals as partners.

Revenues are shared among the partners in accordance with the partnership agreement. That can be good or bad depending on whether any members have to be carried financially and how frequently this occurs. There is the joint and several liability issues and there is also a more complicated procedure on the dissolution of a partnership.

From a taxation perspective, a partnership computes its income, makes the allowable deductions, then allocates the balance of the income to the partners in their agreed percentages. There is no deferral of income. The partners are then taxed separately on their respective portions. The partnership itself files no tax return.

### Points to Consider: Partnership Agreements

The following are some of the issues that should be dealt with when drafting a partnership agreement: term of the agreement, names of the partners, who owns which of the

assets, name of the partnership and who owns the name, capital contributions if any, how profits are to be shared, how the partnership is to be managed, how holidays and illnesses are to be handled, liabilities and disability insurance, admission and withdrawal of partners, how the partnership is to be run and conditions and mechanics for dissolution of the partnership.

## PURCHASING A LAW PRACTICE

We've all seen those ads for the sale of a law practice in a sleepy little town in the Bruce Peninsula. If the thought of simply taking over a practice that is already up and running with an established reputation in the community seems appealing, then read on. There are some very important factors to consider.

### Check with the Law Society

Place a call to the Law Society. Even without written authorization from the member vendor, you can ascertain whether he or she is in good standing and whether there are pending disciplinary proceedings. With a signed authorization from the member vendor, you can inquire about the number of complaints and the condition of the member's practice. Ask the vendor if there are any actual or contingent liabilities. Problems in any of these areas should send up a red flag. Beware of buying into a liability beartrap.

### Review the Books With an Accountant

Take a look at the books. Better still, have an accountant or bookkeeper look them over. Did the practice make a sufficient profit to satisfy your needs? How much is the annual overhead cost? What is the reputation of this lawyer in the community? Are his or her clients happy with the service they received? Who are the clients and what is the nature of the practice? Is the client base of the practice expanding or has it remained stagnant?

Who are your competitors in the area and what are their strengths and areas of practice? Is the population in the area expanding or remaining the same? How much do you know about the town or city? If you have some basic information about the history of the area, you'll score more points with the clients whose business you hope to retain.

What exactly are the assets you are buying and how technologically advanced is the office equipment? Inquire about the office staff as well. Are the employees happy and competent? If you have to upgrade the computer system, for example, there may be some personnel retraining required.

You will want to look at the existing lease and see if it can be assigned. Many vendors make an offer of assistance to ease the transition period. Lastly, if all of the above hurdles are cleared, you are then in a position to negotiate terms of a buyout. The allocation of the purchase price should be dealt with as a term of the sale and You should consult with your accountant before agreeing to anything in this area, as it will have important tax consequences. Essentially, you the purchaser will want the proceeds of sale



allocated to items that will be fully deductible in the first year and items that can be depreciated at a high rate. The vendor's interests from a tax perspective are antithetical to the purchaser, so make sure you get good solid advice before you negotiate. Lastly, ensure that you have a non-competition clause built into the sale agreement.

## WHAT DO YOU REALLY WANT?

Your choice of business style should suit your personality. Some people have great difficulty collaborating with others when it comes to business. They are far more comfortable making their own decisions and the isolation from other practitioners does not bother them. Others need the security and collegiality of an association or partnership. Our group met numerous times and for many hours over the course of several months before we finally decided to practise together. It takes patience, maturity, humour and a genuine desire to make it work. You have to decide what style fits best for you, your personality and your objectives.

I left associated practice in 1998 and have been on my own ever since. I'm a bit of a control freak and I actually enjoy the quiet of my own office. While I miss the fun office atmosphere I left in Toronto, it is beneficial to me now, for personal and family purposes, to have uninterrupted office time to get my work done. I like having the freedom to take time off. Since my kids were little, I have taken the entire month of August off annually as well as Christmas holidays and March break. My annual income suffers, of course, but not having to worry about paying an employee or delegating any association duties to others allows this freedom.

Make no mistake; there is a financial price to be paid. As Janis Joplin sang, "Freedom's just another word for nothing left to lose".