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How watertight are partnership agreements?

When partners are asked to leave their firm, frequently they will find little protection from their partnership agreements, even if they have been a high performer. Daniel Sutherland of law firm Fox Williams gives advice on how to challenge an expulsion decision

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Being offered partnership is, for many accountants, a high point in their career, reflecting the culmination of years of hard work. But although the rewards of partnership can be great, so too are the risks, particularly when compared with an employee.

Having reached what from the outside seems like the summit, a new partner will find that there is another mountain to climb within the partnership, with expectations of ever better performance year-on-year.

Should a partner (which for these purposes includes a limited liability partnership (LLP) member) stumble in the pursuit of further success, perhaps through no fault of their own, they will find themselves with a far smaller legal safety net than employees.

Unlike employees, partners have no right to bring a claim for unfair dismissal and have no right for that dismissal to be done in accordance with a fair process. Partners have no statutory redundancy pay and rarely benefit from enhanced redundancy packages offered to employees.

Very few other material employment rights, save for protection against discrimination or victimisation, extend to partners. Firmwide policies that apply to employees, such as grievance or disciplinary procedures, rarely apply to partners.

Partners at the outset of their partnership may be willing to forego these employment rights, viewing the prospect of higher remuneration and an ownership stake in the business as a fair exchange for them. Partners also often consider such rights as being irrelevant to them, having only experienced success in their careers.

This attitude can prove short-sighted. Not all partners continue to succeed after promotion and even high-performing partners can find themselves vulnerable. Many highly profitable firms have required partners to leave in the pursuit of enhancing profitability for the remaining partners.

For example, press reports have suggested that KPMG is looking to cut partner numbers in 2020 in a bid to improve profitability to levels more in line with its peers. Since KPMG's profits per equity partner in 2019 were £549,000, people who would be judged as very high performers in most firms could be facing the axe.

Little comfort

A high performer who is only struggling relative to extremely high expectations will no doubt feel hard done by if they are told to leave. Partners who find themselves in such a situation will typically turn to their partnership or LLP members' agreement to understand how they might challenge that decision. That agreement is unlikely to offer much comfort.

Partnership agreements are usually drafted for the benefit of the continuing partners rather than for a departing partner. Harsh (and often enforceable) restrictive covenants are typical and the current trend has been for these to become tougher.

Non-compete covenants are becoming more popular, as are provisions that restrict team moves, or which impose a financial penalty on leavers. Such provisions usually apply irrespective of whether a partner has resigned or they have been required to leave.

Even provisions that appear designed to protect a partner often fail to do so in practice. For example, a partner may initially take heart in finding that decisions as to compulsory retirement usually require a vote of the whole partnership. Such decisions may even require a super-majority of partners to vote in favour.

Unfortunately, in practice, the prospect of the wider partnership riding to the rescue are very limited, with partner votes on such matters usually being a mere formality. It seems few partners are willing to disagree with management decisions.

Even a partner who is confident that a vote would go his or her way may prefer to go quietly by agreement, rather than test that belief in a wider forum, with the potential for embarrassment.

With the deck stacked against the individual partner, the battle may seem lost before it has begun. If a sensible management team has offered a partner some incentives to facilitate a quick and quiet exit, it is usually tempting for the partner to merely try and negotiate a few sweeteners to the offer, sign on the dotted line and focus their energies on finding a new position.

For many partners this is the most sensible route. This route might involve waivers of restrictive covenant, payment of legal fees and an agreed form of reference and announcement.

Notwithstanding the challenges, those partners who truly believe they have been wronged, or who believe it is unrealistic to secure a position elsewhere, or who view the retirement package on offer to be too meagre, may still be minded to fight. When moral arguments have failed, a partner who wishes to take a stand can usually find some legal basis on which to do so.

In any challenge, the key question to ask will be on what basis did the firm's management take the decision to require the partner to leave. Often such decisions are not taken in a manner that is fully in accordance with relevant contractual and legal obligations.

Bad faith

Those obligations often include an express or implied duty to take decisions in good faith. Good faith is best understood by looking for its opposite: bad faith. If a partner can show that a decision was taken in bad faith, it is clearly not in good faith.

Examples of bad faith might include where a power to remove a partner is exercised for an improper purpose, such as to benefit the decision maker, or if it was founded on an unlawful act, such as discrimination. A discriminatory decision not only presents an opportunity to challenge a decision under the members' agreement, it may also be actionable in an employment tribunal.

Another route to challenge a decision may be on the basis of the common law right to challenge the exercise of discretion if it has been exercised arbitrarily or irrationally. For such a claim to succeed, a partner would be looking to show that management had failed to take into account all relevant factors, such as failing to review the correct figures, or took into account irrelevant factors.

Partners who are the victim a hasty 'back of the envelope' approach to dismissals may find this approach helpful, although it can be a hard claim to pursue to a successful conclusion without strong evidence, which a well-advised firm is unlikely to have created.

Ultimately, a partner's greatest weapon when faced with this kind of challenging situation will be the skills, tenacity and confidence that justified their partnership in the first place.

About the author

Daniel Sutherland is a partnership law expert at Fox Williams LLP