CHAPTER I

LAW FIRM ORGANIZATION

I. FIRM STRUCTURE

The small law firm, whether a sole practitioner or a group of attorneys practicing together for economy and comfort, should carefully choose its formal organization. This chapter deals with the forms of legal organizations available to the small law firm and discusses some of the benefits and disadvantages of those forms to the small firm attorney(s).

Whatever the legal form adopted, the attorney remains liable to his or her clients for the proper delivery of legal services and is not shielded from professional liability by formation of a professional association (corporation), limited liability company or limited liability partnership.

The solo attorney or small law firm of several attorneys must consider a myriad of issues in choosing a legal form, financial, personal and otherwise. Some of the matters discussed herein will be related to general business organizations, as a law firm is a business, too. This chapter does not deal with specific tax regulations and dollar figures as they will change from time to time.

The following sections provide in-depth guidelines for choosing among the different possible forms of law firm organizations. They should be read in conjunction with the forms provided.

A. Proprietorships (Solo Practitioners)

Proprietorships may take a number of forms, but discussed here is the solo law practice in which one attorney practices alone with or without the assistance of lay employees such as secretaries or administrative assistants and paralegals. The proprietor is considered in this chapter to be a solo attorney practitioner. Some of the advantages and disadvantages of this form will be addressed below. The terms solo practitioner and proprietor are interchangeable for the purposes of this chapter.

1. General

The simplest form of business entity is the proprietorship. Under this form of organization, the individual attorney conducts business and holds assets personally in his or her name. The attorney proprietor is also personally liable for all contractual and professional obligations of the practice. The practice may be conducted under an assumed name or trade name after complying with N.C.G.S. §66-68 requiring a local filing of an assumed name certificate (Form 1). The use of such a name by a law firm must also comply with the North Carolina Rules of Professional Responsibility.
A proprietorship may have only one owner. If the proprietor brings in a co-owner sharing profits and losses, he or she will have formed a general partnership under North Carolina law, regardless of whether a formal written partnership agreement is executed.

2. **Formation**

There are no organizational documents required to form a proprietorship, other than perhaps an assumed name certificate. As with other forms of organization, a proprietorship practitioner may establish contractual relationships with other parties, hire employees or independent contractors and buy and sell products and services.

3. **Formation and Maintenance Costs**

The proprietorship is the least expensive form of legal entity to organize, because no organizational documents are required other than perhaps an assumed name certificate. Continuing maintenance costs are low. No annual fees are owed the Secretary of State.

4. **Governing Law**

Unlike other forms of business entities, there is no specific body of governing law relevant to proprietorships. However, the solo lawyer practitioner will still be subject to general rules of law and regulatory restrictions with respect to the operations of his or her practice in dealings with other parties.

5. **Liability**

A sole practitioner lawyer is personally liable for all claims against the firm, including those resulting from acts committed by the employees within the scope of their employment. The risk to the solo practitioner from unlimited liability can be managed to some extent with insurance but attorneys with growing practices usually incorporate or form professional limited liability companies as the practices mature.

6. **Continuity of Business**

The existence of a proprietorship is dependent on the continued legal capacity of the proprietor. The law practice would normally be liquidated following the death or continuing incompetence of the solo practitioner. This is accomplished either by selling the separate assets of the firm or transferring the firm to the heirs of the decedent. In the case of attorney law practice, the client files with clients' consent and other assets consisting of the practice may be sold to another law firm. Liquidation requires sale of the tangible assets of the firm. The lack of continuity of existence is considered one of the principal disadvantages of a proprietorship, as it does impact on the estate's ability to maintain the value of the firm upon the demise of the proprietor attorney.
(It is recommended the solo practitioners read the North Carolina Bar Association publication *Turning Out The Lights* to assist them in planning for the closing of their practice. Available as a PDF download on the NCBA Public-Pro Bono website under Publications.)

7. **Transferability of Interest**

The interest of a sole proprietor is freely transferable. However, asset transfers are normally more complicated than transfers of interest in an entity which owns individual assets. For example, a sale of assets may be cumbersome where the assets include contractual rights which require the consent of another party, such as a client, in order to be assigned or where the assets transferred are subject to encumbrances by creditors which would require their consent to assign. Law practices may, however, be sold to or merged with other law firms. See Rule 1.17, N.C. State Bar RPC.

8. **Changing the Form of Entity**

A proprietorship can easily be converted to a limited liability partnership, professional association or professional limited liability company. Conversion of a law practice into partnership or limited liability partnership will, however, require inclusion of a co-owner in the practice. A solo practitioner may form a professional limited liability company (PLLC) without adding a partner under North Carolina law and IRS regulations.

9. **Income Tax Considerations**

A sole proprietor reports business income on his or her individual (1040) tax return. The income is taxed at individual rates and the record keeping requirements are minimal compared to the corporate and partnership requirements. The most significant issue with taxation of the sole proprietor usually involves computation of the self-employment tax. Available deductions, such as the I.R.C. § 179 election to expense capital equipment, yield extra benefit because they reduce the amount of self-employment tax, as well as income tax.

10. **Risk Management**

The following are some risk management considerations for the solo practitioner:

a. Do not accept large or complex cases if you don't have the expertise, time or personnel to handle them. Either refer them to or associate a law firm experienced in that area of practice.

b. Make plans now for the ultimate contingency - your death or unexpected departure from the profession via retirement or otherwise. Arrange for a successor lawyer to take over your cases. Put this arrangement in writing. Make sure your support staff is
acquainted with the successor lawyer. Develop a procedure for the transfer of case files. Set up a contingent fund that will cover rent, salary and office expenses for several months following your death or disability to enable your staff to close or sell your practice in a manner advantageous to your estate. See Turning Out the Lights, a North Carolina Bar Association publication for solo and small law firms planning for the unexpected closing of the law practice (available on the NCBA website, www.ncbar.org under Public-Pro Bono Publications.)

c. Just because you practice solo does not mean you may not enjoy the advantages of consulting with other attorneys. Find other solo practitioners and meet with them regularly, perhaps at weekly luncheons. Ask your fellow solos to proofread your work substantively. Share concerns and swap ideas. Solicit advice on difficult cases.

d. Develop plans for emergencies or unexpected absences by you or your staff.

B. Office Sharing

1. Advantages

Attorneys practicing as proprietors may join together in office sharing arrangements to decrease office operating expenses, most often rent, utilities and personnel. When solo practitioners enter into office-sharing arrangements, it is always wise for them to draft and execute a written memorandum or letter of agreement setting out the ground rules. The memorandum should include amount and sharing of rent; use of support staff; use of phones and office equipment; use of conference areas, permissible changes to the office space occupied and signage. There should be a clear understanding as to representations to the public that the arrangement is not a partnership and contain some malpractice disclaimer. The solo practitioner or firm leasing space and services to the second solo practitioner should avoid the appearance of creating contractual rights in the lessee. Sample office sharing agreements are included as Forms 2 and 3.

2. Disadvantages

In sharing office space, the solo practitioner might also be sharing malpractice exposure. In some situations, lawyers have been held liable for the mistakes of their office mates. This problem arises when clients perceive you and your mates to be partners. Avoid this perception by: (1) clarifying your solo status to clients in the initial interview and the engagement letter; (2) using separate name plates, letterhead and bank accounts; (3) installing separate phone lines; (4) instructing your staff to make your solo status clear when they answer the phone; (5) keeping client files separate; and (6) maintaining client confidentiality. Most important, select your suite mates wisely. Make sure they carry professional malpractice insurance.
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C. General Partnerships

1. General

The basic types of partnerships are general partnerships and limited partnerships. (Limited partnerships are not an organizational option for attorneys under the Rules of Professional Responsibility.) General partnerships consist of two or more partners, each of whom has full status as a partner with unlimited personal liability for obligations of the partnership and full authority to exercise managerial control over the business unless limited by agreement. General partnerships may be created with or without a written agreement and without any Secretary of State filings.

2. Formation

The North Carolina Uniform Partnership Act (UPA) defines a partnership as an association of two or more persons to carry on as co-owners of a business for profit. N.C.G.S. §59-36. No written general partnership agreement is required to form a general partnership. The UPA will define the rights and obligations of the partners if no partnership agreement exists. However, to the extent that the partners enter into a written agreement, the terms of the written partnership agreement will control. If the partnership agreement is silent regarding issues dealt with in the statute, the statute will be controlling.

No specific form of agreement is prescribed for a general partnership agreement. However, it is customary and good business practice to define the rights and obligations of the partners in a comprehensive fashion. Preparation of a written agreement substantially decreases the likelihood of disagreement or litigation regarding the terms of the partnership. Also, a partnership agreement is necessary to the extent that the partners desire to vary from the terms of the UPA. Additionally, the partners will frequently want to be more specific in the terms of their agreement than would otherwise be provided by statute. Drafted partnership agreements should include detailed provisions covering such issues as voting rights and distributions to partners. A sample law firm partnership agreement is attached as Form 4.

3. Formation and Maintenance Costs

The expense involved in organizing a general partnership is generally similar to that for forming corporations. Although a simple partnership agreement can be prepared less expensively or the UPA relied upon with no written agreement, it is advisable for the partners to have a detailed partnership agreement tailored to their particular situation and in which they understand the terms. Where substantial investment is involved, and especially where significant allocation of income and expenses and tax issues may require drafting of more complicated provisions, the partnership agreement will generally require significant negotiation and periodic review by the partners.